

**Letter of Findings: 02-20130238**  
**Corporate Income Tax**  
**For the Years 2008, 2009, and 2010**

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**ISSUES**

**I. Cost-of-Performance – Corporate Income Tax.**

**Authority:** IC § 6-3-2-2(a); IC § 6-3-2-2(e); IC § 6-3-2-2(f); IC § 6-3-2-2(f)(1); IC § 6-3-2-2(f)(2); [45 IAC 3.1-1-55](#).

Taxpayer argues that, for purposes of calculating its Indiana adjusted gross income, it is entitled to source its Indiana sales on a "cost of performance" basis and that the Department's position to the contrary is mistaken.

**STATEMENT OF FACTS**

Taxpayer is an out-of-state business which provides information services. Taxpayer provides information to Indiana customers. Taxpayer earns money from its Indiana customers.

Taxpayer filed an amended 2007 income tax return requesting a refund of tax it had previously paid. Taxpayer also submitted an amended 2008 income tax return. Taxpayer explained that the "amended returns are filed 'to correct the sourcing of certain electronic information services revenue for the purposes of the sales factor of the apportionment percentage . . . .'"

The Department of Revenue ("Department") conducted a review of Taxpayer's 2007, 2008, 2009, and 2010 returns. The 2009 and 2010 returns were also reviewed because – according to the Audit Report – "Taxpayer also reported their Indiana sales figures based on [cost of performance] for 2009 and 2010 . . ." and excluded all of these "information services" revenues – received from its Indiana customers – from its Indiana numerator.

The Department disagreed with Taxpayer's method of reporting its Indiana source income, issued an assessment for 2008 through 2010, and denied Taxpayer's refund request attributable to the 2007 and 2008 returns.

Taxpayer submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

**I. Cost-of-Performance – Corporate Income Tax.**

**DISCUSSION**

Taxpayer provides "information services" to Indiana clients. The clients pay for these services.

Taxpayer argues that the money earned from its Indiana clients should be sourced to Taxpayer's out-of-state location. As explained by Taxpayer:

A comprehensive review of the direct costs associated with [the] income-producing activity giving rise to these service receipts was performed in order to determine the proportion of the costs performed within and without Indiana. The primary direct costs are (1) staffing which includes editorial, research, analysts, systems and database managers, and (2) Information Technology, which includes computers, servers, software development and maintenance. For the previously referenced information services, the review concluded that the majority of the direct costs are incurred outside the State of Indiana.

The Department's Audit Report disagreed:

Upon audit, we believe that "in [T]axpayer's specialized business, the information [T]axpayer acquires and manages would have no value unless that information was offered to and accepted by an Indiana customer. The money [T]axpayer receives is not received by virtue of the activities which [T]axpayer conducts in [other states]. The money is received because the information is "rendered" to an Indiana customer.

Indiana law sets rules for determining what portion of a multistate business' income is subject to Indiana tax.

IC § 6-3-2-2(a) provides in part:

With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state;
- (3) income from a trade or profession conducted in this state;
- (4) compensation for labor or services rendered within this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property to the extent that the income is apportioned to Indiana under this section or if the income is allocated to Indiana or considered to be derived from sources within Indiana under this section.

During the relevant period, Indiana's "apportionment formula" was based on three factors which were "weighted" differently during the Audit Period. For purposes of this protest, the "receipts factor" is relevant as set

out in IC § 6-3-2-2(e), (f).

(e) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. Sales include receipts from intangible property and receipts from the sale or exchange of intangible property. However, with respect to a foreign corporation, the denominator does not include sales made in a place that is outside the United States. Receipts from intangible personal property are derived from sources within Indiana if the receipts from the intangible personal property are attributable to Indiana under section 2.2 of this chapter. Regardless of the f.o.b. point or other conditions of the sale, sales of tangible personal property are in this state if:

- (1) the property is delivered or shipped to a purchaser that is within Indiana, other than the United States government; or
- (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and:
  - (A) the purchaser is the United States government; or
  - (B) the taxpayer is not taxable in the state of the purchaser.

Gross receipts derived from commercial printing as described in

[IC 6-2.5-1-10](#) shall be treated as sales of tangible personal property for purposes of this chapter.

Receipts from the sale other than tangible personal property or from certain intangibles are sourced according to IC § 6-3-2-2(f) which states:

(f) Sales, other than receipts from intangible property covered by subsection (e) and sales of tangible personal property, are in this state if:

- (1) the income-producing activity is performed in this state; or
- (2) the income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance. (Emphasis added).

The Department's regulation, [45 IAC 3.1-1-55](#), interprets IC § 6-3-2-2(f). The regulation states:

When Sales Other Than Sales of Tangible Personal Property Are in This State. Gross receipts from transactions other than sales of tangible personal property shall be included in the numerator of the sales factor if the income-producing activity which gave rise to the receipts is performed wholly within this state. Except as provided below if the activity is performed within and without this state such receipts are attributed to this state if the greater proportion of the income producing activity is performed here, based on costs of performance. The term "income producing activity" means the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit. Such activity does not include activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, "income producing activity" includes but is not limited to the following:

- (1) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.
- (2) The sale, rental, leasing, or licensing the use of or other use of tangible personal property.
- (3) The sale, licensing the use of or other use of intangible personal property.

Income producing activity is deemed performed at the situs of real, tangible and intangible personal property or the place where personal services are rendered. The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property.

The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer. If receipts from sales other than sales of tangible personal property do not constitute a principal source of business income and such receipts are included in the denominator of the receipts factor, such receipts are in this state if:

- (a) the income producing activity is performed wholly within this state; or
- (b) the income producing activity is performed both in and outside this state and a greater proportion of the income producing activity is performed in this state than in any other state, based on costs of performance.

Except as provided by special apportionment formulas, receipts from sales other than sales of tangible personal property which constitute a principal source of business income shall be attributed to this state in accordance with the following:

- (a) Gross receipts from the sale, lease, rental or other use of real property are in this state if the real property is located in this state.
- (b) Gross receipts from the rental, lease, licensing the use of or other use of tangible personal property shall be assigned to this state if the property is within this state during the entire period of rental, lease,

license or other use. If the property is within and without this state during such period, gross receipts attributable to this state shall be based upon the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during such period.

(c) Income from transportation between a point in Indiana and a point outside Indiana shall be attributed to this state on a mileage basis. See Regulation 6-3-2-2(l)(020) [[45 IAC 3.1-1-63](#)].

(d) Gross receipts for the performance of personal services are attributable to this state to the extent such services are performed in this state. If the services are performed partly within and without this state, such receipts shall be attributed to this state based upon the ratio which the time spent in performing such services in this state bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligation, as for example, time expended in negotiating the contract, is excluded from the computations. (Examples omitted).

Taxpayer disputes the Audit's conclusion that Taxpayer's receipts are governed by IC § 6-3-2-2.2(e) because "Taxpayer's receipts clearly were not derived from fiduciary services, and they do not fit with the apparent meaning of 'other services.'"

The audit report pointed out that the rule for determining if "income-producing activity" is performed in Indiana and if the money earned from that activity is included in the numerator of the sales factor is found in [45 IAC 3.1-1-55](#). Under that provision, the general rule is that "the income-producing activity" is "deemed performed" and is attributed to "the situs of the real, tangible, and intangible property" or to the place "where the personal services are rendered." However, the term "income producing activity" is defined as "the acts or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit."

The Department concludes that the actual "income producing activity" is performed in Indiana because "the acts or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit" occur in Indiana. [45 IAC 3.1-1-55](#). Taxpayer does not earn money from conducting out-of-state financial research; Taxpayer does not earn money because a specific Indiana customer hires Taxpayer to conduct out-of-state financial research on that particular customer's behalf; Taxpayer earns money because it conducts financial research and then sells the results of that research to Indiana customers. The money earned from those Indiana sales transactions constitutes Indiana source income.

In summary, receipts from any "income producing activity" performed in Indiana are always attributed to Indiana under IC § 6-3-2-2(f)(1); all of the receipts or a principal source of business income are attributed to Indiana when, under the cost of performance rules, the greater proportion of the income producing activity is performed in Indiana under IC § 6-3-2-2(f)(2) and [45 IAC 3.1-1-55](#).

The "cost of performance" rules apply in two situations: (1) when attributing all of the receipts for a principal source of business income to Indiana because the greater proportion is performed in Indiana; (2) when income is not a "principal source of business income" and the greater proportion of the income producing activity is performed outside of Indiana. While Taxpayer has service income derived from intangible property, the income is a "principal source of business income" for Taxpayer and is from "income-producing activity" that was performed in Indiana under [45 IAC 3.1-1-55](#).

#### **FINDING**

Taxpayer's protest is respectfully denied.

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